The Mosaic Financial Group LLC
Your Wealth Management Partner

Developing Portfolio Expectations

Would you accept 10% less return on stocks annually every year to experience 40% less volatility than stocks? If you would, you're on the way to developing realistic investment return expectations.

This article is not investment advice but intended only as an exercise to help readers develop expectations about generating retirement income or building enduring family wealth. It's not an easy read, but developing portfolio performance expectations is important and requires thought.

Thinking through your return expectations may help in maintaining a long-term strategic view through bear markets. This article also may help separate stock performance from performance of a diversified portfolio.

Investors commonly expect a 10% annual return. To be clear, the Standard & Poor's 500 stock market index has averaged a 10% return for decades. But it assumes 100% of your portfolio is invested in stocks.

The accompanying table shows the annualized risk and returns of seven distinct assets for the 50 years ended December 31, 2022. The seven assets were selected because, as a group, they comprise a diversified portfolio and have been indexed publicly since 1970, according to Craig Israelsen, Ph.D., who teaches about portfolio design at Utah Valley University.

Diversification reduces the risk of major losses from investing in a single security or single asset class. In

7-Asset Diversified Portfolio Risk & Return, 1973-2022

1973 – 2022	Large US Equity	Small US Equity	Non-US Equity	US Bonds	Cash	Real Estate	Commodities	7-Asset Equally Weighted
50-Year Average Annual Return	10.32%	11.07%	7.77%	6.60%	4.49%	10.65%	5.90%	9.14%
50-Year Standard Deviation of Annual Returns	17.69%	21.34%	21.15%	7.06%	3.64%	20.10%	25.13%	10.59%
% of Time with Positive Annual Return	78%	70%	70%	90%	100%	78%	68%	84%
Worst Three-Year Cumulative % Return	-37.61%	-22.85%	-43.32%	-7.92%	0.14%	-35.61%	-55.60%	-13.37%

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Spotlight On... Jimmy Zerjov

Hello, my name is Jimmy Verjoz. I am a tax associate with Mosaic and started working here in February of 2021.

I graduated from Northeastern Illinois University, Summa Cum Lade, with a degree in finance. I became interested in taxes after taking a few federal income tax courses and Mosaic has been an excellent place to advance in my career.

During my free time, I enjoy hiking, riding my bike along the lake, working out, and traveling. I enjoy learning about different cultures and trying new restaurants. Last year I visited London, Greece, and Albania. In 2023 I plan to visit Amsterdam, France, and Belgium.

Long-Term Care Insurance Policy Alert

Forty percent of Americans over the age of 65 suffer from a physical or cognitive disability and the number of those requiring long term care is growing sharply. However, buying insurance that will pay for a long-term stay in a nursing home places consumers in a hard to navigate area of personal finance, where professional guidance is very important.

For many years, long-term care insurance (LTCI) policyowners have been forced to accept lower benefits or pay more to keep their policy's current benefits. Although state regulators are required to approve price hikes and benefit reductions, rarely do regulators refuse to grant insurers requests. Rising health care costs and technology have made LTCI policies difficult for insurers to price.

To be clear, companies that manufacture and sell insurance policies start with one set of policy benefits and prices, but they are often subject to change over the years. Pricing the cost of a nursing home, home-care, and other policy benefits is complicated. How complicated?

Compared to the calculation involved with figuring out an individual's risk of dying, LTC insurance policies are much more complicated products. Life insurance involves one risk: mortality. Calculating an individual's risk of dying is the single risk insurers need to price in to sell a life insurance policy. In contrast, long-term care insurance involves two risks – bad health as well as mortality.

Calculating an individual's risk of bad health as well as their life expectancy requires more actuarial calculations than a life insurance policy. Keep in mind, insurers customarily require your health records to determine your personal risk of heart disease, dementia, cancer, and other chronic diseases. The insurers routinely require access to your health history before pricing your personal policy proposal.

Advising on LTCI requires analysis from a qualified professional based on your personal health and mortality risks. If you would like help pricing Long-Term Care Insurance, please contact us. ●

As The Bear Market In U.S. Stocks Stretches On, Remember

Stock bear markets in the post-War era lasted an average of about 11 months.

The current bear market began June 13, 2022. That was when stocks, as measured by the Standard & Poor's 500 index, declined by more than 20% from their all-time high price of January 3, 2022.

The bear market will not end unless and until stock prices recover and surpass their early-2022 high price. That's a real risk, and it helps explain why the U.S. stock market became the premier risk asset for long-run investors across the world. It also helps explain a crucial paradox of investing for the long run.

U.S. stocks are unique among the world's investments because they not only possess a history of 10% annualized returns, but they are also liquid. They can be sold anytime. Diamonds, private investments, and other equity assets are generally not as liquid. Nor do they generally possess the documented history of appreciation of the S&P 500.

As the bear market in stocks stretches on, we want to remind you of a paradox of long-term investing: Putting up with periodic losses in the world's leading equity market has been a good investment. Yes, the nation's 500 largest publicly investable companies are a risky investment. However, they have been the key driver of growth for retirement portfolios and family wealth.

The equity risk premium, which is illustrated on the right, shows the rewards received annually for tolerating stock risk versus a risk-free investment.

In the 20 years ended December 31, 2022, stocks averaged a 9.8% annual return, more than seven times the 1.2% of riskless 90-day U.S. Treasury bills.

Subtracting the average annual return on T-bills from the return on stocks, the resulting 8.6% is the premium stock investors over the past 20 years annually earned for taking the risk of owning U.S. stocks. T-bills are considered risk-free because they're backed by the full faith

New Retirement Rules Impact All Ages & Incomes

New rules of retirement just went into effect. They usher in changes in tax rules affecting Americans of all age and income levels.

With nearly 40% of today's workers financially unprepared for retirement, according to the Center for Retirement Research at Boston College, the changes represent steps by the government to prevent the nation's retirement funding crisis from growing worse.

The new retirement rules are known as SECURE 2.0, but Congress formally entitled the law, The Securing a Strong Retirement Act 2.0.

How We Got Here. SECURE 2.0 expands on retirement rules signed into law by President Donald Trump in December 2019, the Setting Every Community Up for Retirement Enhancement (SECURE) Act. SECURE 2.0 is one part in the 4,155-page, $1.7 trillion Consolidated Appropriations Act of 2023 (CAA). The 4,155-page bill funds the U.S. government through September 30, 2023, enabling a long list of national priorities, such as aid to Ukraine and domestic disaster relief as well as retirement provisions in SECURE 2.0.

Effective Dates. Some of the new rules on retirement became effective January 1, 2023, while others won't kick in for many years. The new rules benefit retirees and pre-retirees in 2023 and will boost retirement funding for Americans for generations. Here's a summary of key provisions affecting retirement planning for individuals.

Start At 73. In 2023, the age at which you are required to start taking annual distributions from an IRA or qualified retirement plan sponsored by your employer rises from 72 to 73. The age at which you must start taking distributions rises to 74 in 2030, and 75 in 2033. Delaying distributions enables money to compound without being taxed for longer, bolstering retirement assets and reducing taxes on assets left to children, grandchildren, and other beneficiaries.

Automatic Enrollment. Funding retirement security is highly correlated with participation in a qualified federal plan, such as an IRA, 401(k), or 403(b). So, automatic enrollment of employees will be required in newly-created federally qualified plans starting in 2025. Employees can opt out, but no longer will be required to proactively opt in.

Larger Employer Matches. Employers will be required to make annual contributions equal to or greater than 3% of an employee's wages. Employers can match contributions equal to as much as 10% of your wages. Employers can hike their matching contributions by 1% annually they match as much as 10% — with the option of up to a 15% matching contribution. Company retirement plans, thus, thus, become a much more important factor in employee compensation and in attracting and retaining employees.

50-Plus Catch Up. A "catch-up" provision has long enabled those age 50 or older to boost contributions to IRA, 401(k) and other federally qualified retirement plans. For those ages 60 through 63, the $7,500 catch-up amount permitted in 2023 rises to $10,000 on January 1, 2025, and the catch-up amounts will be indexed to inflation annually. The enlarged catch-up contributions are a potent new last-minute tactic to make up for a shortfall in funding retirement.

Get With A Plan. Under SECURE 2.0, companies can give employees gift cards and incentives worth up to $100 to encourage participation in the company retirement plan in 2023. Until now, in an effort to protect workers from conflicts of interest, employers were prohibited from using incentives.

Part-Time Help. As of 2023, part-time employees can participate in a retirement plan, under SECURE 2.0 after three consecutive years of service. In 2024, the waiting period drops to two years of consecutive service.

Small Business Credit. In 2022, small businesses with up to 50 employees were eligible for a credit on 50% of the cost of starting a qualified plan. In 2023, the credit rises to 100%. The increase does not apply to defined benefit plans.

Military Families. Military spouses often fail to qualify for participating in qualified plans because they relocate so often. Under SECURE 2.0, in 2023, small employers are eligible for a tax credit for allowing military spouses to participate in a plan with no waiting period.

Student Loan Debtors. For individuals hobbled by student loan payments, your employer can make contributions to retirement plan that match your student loan payments —even if you contribute nothing to your plan. That's big!

Lower Wage-Earners. A tax credit for lower income wage earners doubles from $1,000 to $2,000 in 2027. For example, joint-filers with $41,000 to $71,000 of income (single filers with $20,500 to $34,000) qualify.

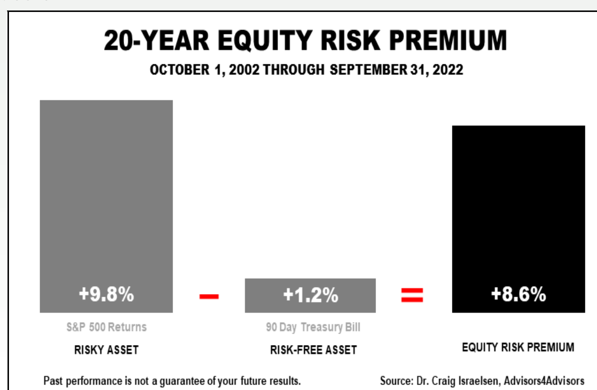
Some critics say SECURE 2.0 did not go far enough in helping lower-income earners and "gig" workers. The Congressional Budget Office says the Act will boost tax revenue by $158 million in the 10 years ending in 2031, and make participating in a plan more important in financial planning. This list is only a sampling of how the new rules in SECURE 2.0 will affect individuals. ●

The Paradox Of Long-Run Investing

and credit of the United States.

In contrast, stock investments are not guaranteed. Stock prices fluctuate unpredictably, depending on investor sentiment and economic conditions. Theoretically, all 500 companies in the S&P 500 index could go bust, and an investment mimicking the index could be totally lost. In addition, there is no guarantee the strong returns earned on stocks will be repeated in the future.

That is precisely why stocks have paid a significant premium over a riskless investment. It's the great paradox of investing and important to remember under current conditions. ●



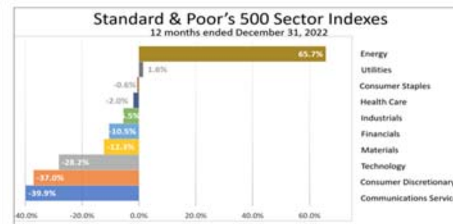
Market Data Bank: 4th Quarter 2022

THE BEAR MARKET OF 2022

Stocks posted a strong gain in the fourth quarter of 2022, following three consecutive losing quarters. This chart shows the evolution of the bear market that began on June 13, 2022, as inflation fear spread. Inflation has been lower, but is likely to continue to be a drag on the outlook for economic growth and stocks in 2023.

FOUR BEAR MARKETS IN FIVE YEARS

In the five years ended Dec. 31, 2022, the S&P 500 stock index total return, including dividends, was +57%. A $1 investment grew to $1.57. However, it required staying invested in stocks through four bear markets. It's easy to see why sticking to a strategic plan was the best way to manage portfolio risk.



INDUSTRY SECTORS

Of the 10 industry sectors comprising the S&P 500 stock index, energy topped the list in 2022, with a +65.7% return. Energy was the No. 1 sector for the past five consecutive quarters, but it was the worst sector for the five quarters ended 4Q 2020. Formerly hot technology stocks experienced a -28.2% loss.

INDEXES TRACKING 13 ASSET CLASSES

Despite the bear market, No. 1 of the broad array of 13 indexes representing investments for the five years ended Dec. 31, 2022, was U.S. stocks. Bonds and foreign equities were laggards. While energy returns were strong in 2022, the index of crude oil investments lost –12.5% versus the +56.9% on the S&P 500 index.

EQUITY RISK FOR THE PAST 20 YEARS

Although stocks are risky, and subject to bear market drops of 40% or more, they paid an average premium of +8.6% annually over risk-free 90-day U.S. Treasury Bills for the past 20 years. This included bear markets in 2002, 2008, and early 2020 as well as 2022. This is why stocks are a growth engine in a diversified portfolio.

7-Asset Diversified Portfolio Returns Over 50 Years, 1973-2022

1973 – 2022	Large US Equity	Small US Equity	Non-US Equity	US Bonds	Cash	Real Estate	Commodities	7-Asset Equally Weighted
50-Year Average Annual Return	10.32%	11.07%	7.77%	6.60%	4.49%	10.65%	5.90%	9.14%
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Worst Three-Year Cumulative % Return	-37.61%	-22.85%	-43.32%	-7.92%	0.14%	-35.61%	-55.60%	-13.37%

50-YEAR, 7-ASSET RISK & RETURN

This is the most important graphic in this report. It summarizes risk and returns of seven distinct asset classes over 50 years. A 7-asset equally weighted portfolio returned nearly as much as an all–stock portfolio but its value fluctuated much less. This illustrates a key principle in portfolio management.

Past performance is not a guarantee of future results. Indices and ETFs representing asset classes are unmanaged and not recommendations. Foreign investing involves currency and political risk. Bonds offer a fixed rate of return while stocks fluctuate. Investing in emerging markets involves greater risk than investing in more liquid markets with a longer history. Indices are unmanaged and not available for direct investment. Investments with higher return potential carry greater risk of loss. Sources: Sector performance data from Standard and Poor's. Equity risk premium data from Craig Israelsen, Ph.D., of Advisors4Advisors. Large-cap US equity represented by the S&P 500 Index from 1973-2022. Small-cap US equity represented by the Ibbotson Small Companies Index from 1973-1978 and the Russell 2000 Index from 1979-2022. Non-US equity represented by the MSCI EAFE Index from 1973-2022. Real estate represented by the NAREIT Index from 1973-1977 and the Dow Jones US Select REIT Index from 1978-2022. Commodities represented by the Goldman Sachs Commodities Index from 1973-2022. U.S. Aggregate Bonds represented by the Ibbotson Intermediate Term Bond Index from 1973-75 and the Bloomberg Aggregate Bond Index from 1976-2022. Cash represented by 3-month Treasury Bills from 1973-2022.

Developing Portfolio Exptectations

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addition, 50 years of risk and returns are a lot, and history rhymes or repeats periodically. Which makes this is a constructive way to plan for the decades ahead.

Of the seven assets, U.S. small company stocks offered the best return. However, they also experienced the greatest risk, as measured by standard deviation. Because of their price volatility, high-risk/high-return investments tend to be more aggravating. How aggravating? So aggravating that you may agonize over whether to sell when their losses are large and their outlook is grim. Selling when prices are low is, of course, the opposite of the strategy long-term investors want to implement.

What's the prudent long-term strategy to be gleaned from the past half-century? The asset class with the best risk/reward tradeoff was large company stocks, as measured by the S&P 500 stock index. The seven-asset portfolio was much more efficient, offering 90% of the return of the S&P 500 but with 40% less volatility.

Aligning your expectations with data in this table may help as the bear market approaches its one-year anniversary on June 13, 2023.

Indexes representing asset classes:

Large-cap US equity represented by the S&P 500 Index from 1973-2022; smallcap US equity by Ibbotson Small Companies Index from 1973-1978 and Russell 2000 Index from 1979-2022; non-US equity by MSCI EAFE Index from 1973-2022; real estate by NAREIT Index from 1973-1977 and Dow Jones US Select REIT Index from 1978-2022; commodities by Goldman Sachs Commodities Index (GSCI) from 1973-2022. As of February 6, 2007, GSCI became S&P GSCI Commodity Index; U.S. Aggregate Bonds by Ibbotson Intermediate Term Bond Index from 1973-75 and Bloomberg Aggregate Bond Index from 1976-2022; cash by 3-month Treasury Bills from 1973-2022. ●

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